

The Darker Side of Internet Shopping

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ABSTRACT

Despite the recent failures of many e-businesses, the consensus remains that firms will need to develop e-commerce strategies if they are to compete in the future (Porter, 2001). However, there is little by way of research on how firms can successfully do so. We examine a case of a large global Internet start-up in a heretofore-neglected sector - adult entertainment. Findings indicate the difficulties faced by Internet start-ups as they seek to build mass-market penetration, while controlling marketing and acquisition costs. The case demonstrates the role that historical positioning and previous industry associations play in the development of an online brand.

INTRODUCTION

It has been argued that the introduction of Web browsers and servers in the early 1990s revolutionised marketing (Borders, Johnston and Rigdon, 2001; Pitt, Berthon and Berthon, 1999; Baker, 1998). Companies could now reach consumers anywhere in the world at very low cost, while consumers could easily find product and company information (Cortese and Stepanek 1998; Hanson 2001; Sheth and Sisodia 1997). The number of Internet users worldwide was expected to increase (from 200 million in 2000) to 399 million by the end of 2002 (Boyatzis 1999). *Forrester Research* (1999) (a highly regarded online research firm) estimated that American consumers alone spent US\$3.3 billion via electronic commerce in 1998, which was believed to increase to US\$82 billion by the year 2003.

In the late 1990s, electronic commerce was being heralded as the 'New Economy' (e.g. Levy 2001; O'Connor and Galvin 2001), and most Web-based businesses claimed they would be

profitable within the next 12-24 months, resulting in the biggest investment euphoria since the 1920s. However, since 2000 many dot.com businesses have hit the wall and an estimated one trillion dollars have disappeared from the market (Boyer 2001). Turner (2000) argues that the main reason why most online operations do not make money is that they fail to understand the full implications of electronic commerce, while Porter (2001) and Griffith and Palmer (1999) stated that many of the problems faced by dot-coms related to a lack of strategic focus.

For Porter (2001), the main issue surrounding the use of the Internet in business related not to whether to deploy Internet technology, but how to effectively do so. Porter believed the Internet offered companies many advantages, such as reducing channel members, and improving the efficiency of procurement. However, he also noted that it made the threat of substitutes more likely, and increased the bargaining power of consumers. More importantly, barriers to entry were seen as very low, and the public nature of the Internet meant that newcomers, many of who were unencumbered by old technology, could quickly duplicate sites (Hamill, 1997). For Porter (2001), successful positioning on the Internet involved the application of well-grounded business principles. However, the positioning school that Porter represents, represents just one of several schools of strategic thought, and potentially may be the least useful in terms of understanding competitive behavior in unpredictable markets (Mintzberg, Ahlstrand and Lampel, 1998).

It would be fair to say that Internet businesses face unique challenges, both in terms of marketing, and operations. To examine these issues, it seems reasonable to examine firms' that are operating Internet business successfully, particularly in an industry context that seems perfectly suited to on-line sales (Aldrich, 1999; Mintzberg et al, 1998). Li and Gery (2000) stated that some products are inherently more suitable than others to online sales. Hofacker

(2001) states that a key benefit of the Internet is perceived confidentiality. This is critical where there is an embarrassment factor associated with the purchase or use of a product or service, such as adult entertainment. The total adult market (legal and otherwise) is estimated to be \$US60 Billion, which is "going to explode exponentially because of the Internet." (Kirkman, 2001: 20)

More than 10,000 companies worldwide are offering adult entertainment and/or products for sale over the Internet (this number is expected to increase) (Boyatzis 1999), and many are managing to turn a profit, where their more mainstream counterparts have not. For example, Barcelona based *Private Media* has turned high cash flow and customer use into profitability inside of two years (Kirkman, 2001). One reason why adult entertainment and/or products are likely to succeed on the Internet is because they are simple and easy to understand, have global appeal, are easy to ship to the consumer, and can be easily standardised. The often questionable legal status of much of the industry also means that less public mediums such as the Internet offer many providers a means of accessing a larger market, without risk of legal repercussions (Dodes, 2001). This paper examines the marketing strategies and tactics of the newly established AdultShop.com (Adultshop), in order to understand the challenges underpinning the strategic use of the Internet as a major retail channel.

METHODOLOGY

The Adultshop case was developed using a range of methods. An interview was conducted with the company's Managing Director for around an hour at the end of 2000. Questions focused on the competitive nature of the industry, the company, and the company's strategies. We also discussed strengths and weaknesses of the company, marketing activities, and

relationship marketing programs (including the selection criteria for suppliers). This data was then heavily supplemented by secondary information gained from the press, institutional reports on the Adultshop outlook, the company's web site¹, their quarterly earning statements, and company reports. While the company operates in English and German speaking countries, only English language documents were sourced². In all, over 300 pages of secondary data were examined for the case. This data contained information relating to the company's strategy and performance from start-up through to October 2001. Further questions were faxed to the company's Chairman in 2001 (a request for a further interview was declined due to lack of time). These questions involved issues arising from the secondary material, and market analysis. All questions were promptly responded to. A draft case was then prepared. This consisted of a lengthy description of the case, and key themes emerging from the case.

FINDINGS AND DISCUSSION

The presentation of the findings will revolve around Figures 1 and 2. Briefly, these figures trace the evolution of the marketing approach used by Adultshop, with Figure 1 highlighting how the company built its brand and position, primarily using relationships throughout the supply chain, to underpin its brand building activities using transactional marketing. The aim here was to develop a market position, cash flow, and market share. Figure 2 indicates how this strategy is evolving into a full-blown network approach, as the company tries to consolidate its position, and retain customers in order to convert cash flow into profitability. Before going into detail on each of these figures, an overview of the case, its performance to date, and the industry environment, will be presented. A detailed discussion of the company's strategic evolution will follow, and a critical discussion of the challenges facing the company, and implications for e-business will follow.

Case Overview

Perth-based entrepreneur Malcolm Day founded the company. In a recent press interview (Treyvaud, 2000), Day stated that the idea for the company came to him during a holiday in Miami where he couldn't help but notice the proliferation of phone sex operators and the booming adult product industry. In 1996 Malcolm set up partnership with Rod Smith, then the director of *Barbarellas* chain of adult shops. AdultShop.com Limited was formed in 1999 through the reverse merger of the *Barbarellas Group* (*Barbarellas* was an established brand name in Australia and New Zealand, selling erotic products via retail shops, mail order, wholesale and online), and the Australian mining company *Western Minerals NL*. Within a year and a half Adultshop was turning over \$A1.2-\$A1.3m³ per month. This performance enabled the company to raise significant amounts of equity capital, with the new adult company listing on the Australian and German stock exchanges in mid 1999. A time line of the evolution and development of the company is presented in Table I.

Take in Table I

Adultshop's stated mission is:

To be recognised as a global leader in the adult industry, committed to building businesses that satisfy an increasing range of customers by providing superior products and services, while providing rising returns for the investors. Recognising each business and market as individual, we are committed to listening, acting and developing beyond expectation. To achieve this, we will expand our online businesses globally by targeting mainstream consumer markets through the

effective communication of the unique AdultShop.com brand. At the same time, we will continue to strengthen our offline operations and increase our offline market share in our home market. We will recognise opportunities presented by technological advances and changes in consumer demand to grow our business and create competitive advantages for our Company.

The company stated that the critical path to establishing the business involves the following five stages: public listing; infrastructure development and marketing strategies; build the brand; acquire and retain customers; and acquisition and provision of content. The company's initial planning focused around the following issues:

1. Focus on adult and erotic products solely.
2. “Mainstream” product and service offerings via marketing and public listing.
3. Raise funds in an IPO in Australia and publicly list in Germany.
4. Develop local offerings in each market, supported by bricks-and-mortar services, experiences and alliances.
5. Seek partnerships and acquire fulfilment channels to maximise customer satisfaction with service and retain customers.
6. CEO to drive strategy and to take best advice on the application of technology.
7. Innovate new product and service offerings.

The principle competing factors that have been identified by Adultshop include; name recognition, price, response speed, cost of postage and handling, range of product selection, ease of use, functionality, customer service, convenience, reliability and purchaser anonymity (Boyatzis, 1999). Adultshop is not a pure Internet retailer, and has recently developed a bricks and mortar retail business in Australia to help support the brand. Adultshop plans to expand its global e-tailing presence and range of products and services both online and offline. This primarily involves increasing market share in the Australasian, North American and European

adult e-tailing markets, and targeting new geographical markets such as the United Kingdom and Japan.

Industry Environment

The company saw opportunities to develop a global adult product brand due to both the fragmented nature of the industry (apart from large entertainment corporations such as *Playboy*, few global firms, and even fewer global brands exist), and the preferred anonymity of many customers. The Internet was believed to offer much potential for the adult industry to move beyond traditional regional, or country boundaries, and develop global brands. As Adultshop's Managing Director stated:

Adultshop saw the potential of this technology to reshape the industry, and was the first to adopt Internet technology as a means of global expansion and brand building.

The adult industry, in one form or another, has existed for thousands of years. However, much of industry remains fragmented, with small local retailers or suppliers supplying a select market of loyal customers, often in a clandestine manner. The fragmented nature of the market holds true for both online and traditional retail, with online retailers often dealing with highly specialised, and often illegal products and / or services. While this fragmentation presents an opportunity for new entrants, it also poses some problems.

Firstly, the clandestine nature of the industry has resulted in the industry as a whole gaining (among many other things) a 'sleazy,' 'immoral,' or 'trashy' image. The fragmentation of the industry has only helped to ensure the continuance of these associations, as no firms have the necessary size or market presence to position themselves as a 'legitimate' mass-market

organisation (Meyer and Rowan, 1977). Rather, small firms dominate the market, often dealing with small groups of highly loyal, but largely anonymous customers. To date, the Internet operations in this industry have only increased the negative perception of the adult industry (with widespread media coverage on the problems associated with online child porn sites), as well as increasing customer anonymity⁴.

Adultshop's customers by law must be over 18 years old. The success of the brand, and ultimately the company, is dependent on Adultshop's ability to attract new, or in trade parlance, 'virgin' consumers to the site: "We saw a great opportunity to offer adult products online," says Day, "especially for a large part of the market that either did not live near an adult retail outlet and may have been nervous about visiting a store." The deliberate positioning away from the traditional sex industry is a core part of Adultshop's strategy. As Day stated, "We are in the adult entertainment industry, not the sex industry."

Day says a major part of the execution to become a mainstream brand involved the company changing consumer perceptions: "It was important to make our adult products and service offerings mainstream and accepted in the communities in which we operate. In many ways we have managed, through our brand campaign, to help make buying erotic goods online acceptable." The company believes that for every person who walks into a sex shop there are 50 who would like to but won't. Day stated, "The Internet will remove that barrier, the stigma associated with such shops." However, this strategy may be difficult to implement, with people wanting to buy adult products being reticent to hand over their credit card number. A spokesman for www.consult.com stated, "At a shop, at least you could disguise yourself in dark glasses, but with a credit card, the purchase can be traced." (Anonymous, 1999)

The company is targeting both men and women, in Europe, America, Australia and New Zealand. Working adults are the primary target market, as they have the buying power to purchase the company's products on an ongoing basis. As Day stated:

Adultshop's consumers tend to be more adventurous, and open to trying new ways of enhancing their sex lives. The benefits of the products retailed at Adultshop are to assist their customers in obtaining self-satisfaction and a route to a better sex life.

Adultshop's competitors include other adult Internet sites, adult stores, adult telephone service businesses, video stores and strip clubs / escort services. The most direct competitors are other Internet sites that offer similar products and services⁵. It is also expected that the number of competitors and the strength of existing ones will increase. This is due to low barriers of entry (Boyatzis, 1999). The most intense competitors are the physical adult retailers. These shops sell similar products and services to Adultshop through retail outlets. Two examples of these include *Addiction Adult Store* and *Condom Kingdom*. The advantage these stores have over e-tailers is that customers can interact with the products before they buy, increasing the customer's confidence about the purchase decision. The disadvantages of these stores is that they are not very discreet, nor do they carry the range of additional services that on-line shops do, or provide extra services such as advice on sex life or discussion boards.

An idea whose time has not yet come?

The historical and environmental constraints mentioned above place constraints on the options available to Adultshop (Aldrich, 1999). As a result, Adultshop has embarked on a strategy to create a global brand among mass-market consumers, using transactional

marketing approaches through the traditional media (such as mass advertising –see Plate 2), and the acquisition of established product brands (see Table I) in the adult industry (which can result in the company gaining access to customer lists). However the established image of the adult industry among targeted consumers, and the continuance of association between 'adult products' and more questionable forms of adult entertainment (not to mention illegal ones), suggests that Adultshop will struggle to gain 'legitimacy' in the eyes of the customer and community (Meyer and Rowan, 1977). To overcome this problem will involve reducing significant legislative and cultural barriers, and suggests that Adultshop will be vulnerable to competition from such sites as Amazon.com (should they chose to expand their range to include adult products), or other retailers that embody more legitimate business forms (Aldrich, 1999). It may be that Adultshop embodies a concept which is ahead of its time (Stinchcombe, 1965), and that the business will face a significant 'liability of newness' problem (Aldrich, 1999).

Finance and performance

Most of the 'hot' Internet firms have posted minimal or nonexistent profits (Boyer 2001), while born and bred e-tailers have thus far struggled (Keh and Sheih, 2001). Adultshop is no exception to this. While a number of online adult sites have managed to convert cash flow into profitability (e.g. *Private Media* (Kirkman, 2001)), these businesses are dealing mainly with a small clientele (Dodes, 2001). Adultshop on the other hand is trying to reach a new client base, by building a global brand among everyday mass-market consumers. As such, it is more likely to face the usual difficulties associated with start-up businesses. Figure 3 highlights the cash flow of the company in its first full year of operation (March 2000-2001). As Figure 3 shows, the company has had the benefit of substantial cash reserves to fund its

aggressive acquisition and brand marketing strategy. However, the changing sales picture indicates that the company will have to grow sales if it is to continue this strategy (while no detail is available on receipts from sales or forecasts for the rest of 2001, the company stated publicly that sales have increased considerably, and in the case of Internet sales had developed better than expected, with the conversion rate of website visitors increasing).

Take in Figure 3

The company has effectively undertaken a two-pronged strategy. Firstly, it aims to develop a strong local base to fund its overseas expansion. This was to be achieved in two ways. Firstly, the purchase of the *Barbarellas* chain aimed to provide cash flow to fund the Internet operations and the growth of the company. Secondly, the company's lucrative phone sex business also provided the day-to-day cash flow to fund operating expenses for the rest of the group. In time, the company hoped to focus away from Australia, and its associated retail and phone sex businesses towards global markets, and online and Adultshop branded retail stores.

This strategy looked to be successful, until February 2000 when legislation was introduced by the Australian government forcing phone-sex customers to register for a PIN number with communication company *Telstra*, unless they used a company that billed its services to credit cards. This has had an immediate effect on the company's revenue base, with Adultshop's results for the year ending June 30 registering an after-tax loss of \$A15 million, compared to the previous year's \$A700, 000 loss. (The company sold sex toys and videos worth more than \$2.8 million while adult phone services recorded sales of \$3.7 million). Managing director Malcolm Day stated, "phone revenues could have been higher if the Federal Government had not effectively banned 90 per cent of phone-sex calls."

If this wasn't enough, the company's other local revenue base, *Barbarellas*, also performed more poorly than expected, with the bulk of Adultshop's \$7.7 million of abnormals representing a goodwill write-down for *Barbarellas*. Benefits from both online and offline sales and a marketing campaign have not yet begun to flow through. As a result, the company has begun to cut costs, possibly at a time, and in areas where it can least afford:

Almost a year after the first dot com state of emergency, the erotic products and services enterprise has come out the other end – somewhat like the fantasies of some of its customers – battered and bruised. Adultshop.com has cut marketing budgets and re-forecast profit expectations. But its business plan is intact and most of its expansion plans appear to be on track. This is despite its share price on the Australian Stock Exchange hovering at about A\$ 0.14, a far cry from the A\$2 listing price in January 2000. But the share price has been lower, and Adultshop.com does have an advantage not enjoyed by some e-tailers – a revenue stream and significant bricks-and-mortar assets. (Burns 2001, pp. 56)

While the company believes its business model is sound, they have now focused their investments in off shore markets, and cut back on advertising and marketing expenditure in Australia. As part of their recent European and American Christmas marketing campaign, the company spent \$A5 million on a marketing campaign to encourage consumers to purchase their products (Greenblat, 2000), while marketing expenditure in Australia has been reduced by nearly two-thirds, from \$800,000 a month to between \$200,000 and \$300,000 a month. This does not appear to have had any negative effect, suggesting that the company has successfully built up brand awareness and achieved its goals in its home market. Day stated in a press interview:

We've dropped our marketing significantly but our sales are still going up. What it means is that we have refined our marketing. We believe our sales will go up even more from not only Internet users but by cross-promotions with our catalogue and retail outlets. (Greenblat, 2000, pp 34)

This focus on building a strong domestic base and then moving internationally would be in line with the approach recommended by Porter (1980), and suggests that either Adultshop has failed to understand the purported 'boundarylessness' of the Internet, or more likely, the cash needs of a large and ambitious start-up affect online businesses in the same way as traditional ones. Either way, the company must address the issue of how it continues to build a global brand on the basis of potentially less cash flow. In Greiner's (1972) terms the business could be seen to be going through a 'crisis,' which is a normal part of the evolution of a new firm.

Global Brand - Standardise or Adapt?

White and Griffith (1997) stated that knowing when to standardise and when to customise in international markets was critical. They argued that the use of information technology could help better position products and services globally, while Griffith and Palmer (1999) stated that firms with a global online presence must pay particular attention to their global marketing mix. Adultshop faces a number of 'standardise or customise' issues, especially in relation to content and delivery. Malcolm Day stated, "About the only homogeneous factor evident is that 'sex sells' - globally. What sells and how it is sold defy global thinking and any thought of standardisation." Purchasing behaviours, sexual behaviours, and local laws are just a few areas that require individual attention. The company notes that American consumers are not as conservative as their British counterparts when it comes to sex. However some American states still outlaw oral and anal sex, with some outlawing the sale of 'replicated genitalia'.

Apart from legislative issues, low credit card usage in some countries presents barriers to the company. In Germany challenges arise as only 20 per cent of consumers use credit cards. As Treyvaud states:

A credit check facility that is publicly accessible means that if you didn't pay the invoice for the vibrator you bought last month then your neighbour, boss or partner has ready access to that information. (2000, pp. 35)

The complex mix of legislative, market, and cultural factors means that the delivery of the Adultshop strategy is often customised through the use of local partners. In Germany Adultshop has registered as a local business for local supply and fulfilment, and local marketing activity. Two expatriate Germans generate the web site from Perth and the top selling 'koala boy' vibrator is sold under a different name. Products ordered in Germany are dispatched from there. Australian orders are dispatched from within Australia (the same strategy is planned for the UK market). “No other online adult products company does this,” claims Malcolm Day (although this strategy would hardly form the basis of a sustainable competitive advantage).

This suggests that while companies aiming to establish a global online brand can largely standardise content (price, product and to some extent promotion), they need to customise process (delivery) through the use of relationship-based strategies. For example, Adultshop claims to have a fulfilment system unique in online erotic industry retailing – localised Web sites and local infrastructure to deliver on the international promise: “We have agreements, mail order support and experienced people in place to make sure fulfilment is from the local market. For us to be a truly global company and compete with local companies in each

country, we have to offer local fulfilment.” Relationships are also needed to tap local market knowledge:

To complete on the local level, you need a local business as well as local marketing, local public relations and local affiliates. You also need to make offerings in the local language. (Malcolm Day)

This is shown in both Figure 1 and 2, as the company uses a number of relationship-based strategies to support, or enhance its content. However, the movement from Figure 1 to 2, indicates that this strategy will evolve over time, and suggests that the use of relationship-based strategies may be more appropriate for market entry, or start-up, than in later stages of strategy and firm development (assuming Adultshop can capture the local knowledge within its own organisational structure) (Aldrich, 1999). For Malcolm Day stated:

This agreement⁶ allows us to enter the US market rapidly and without significant capital outlay. The size of the US Internet community gives an indication of the opportunities awaiting us both in the adult product and adult entertainment markets.

Strategic Evolution

This section will discuss the evolution of the company’s marketing strategy. The company has moved quickly from a pure transactional approach, in which the main goal was to develop brand awareness, to a more relational approach where customer fulfilment was critical, to the current network approach in which customer retention and profitability have become the key aims. This evolution is illustrated in the movement from Figures 1 to 2, and in the prior discussion of the case.

In terms of marketing mix, the company offers a broad range of adult products and services including: e-tailing of adult products, retailing of adult products, adult product wholesale, adult product mail order, telephone services, and adult entertainment. The company runs a number of websites⁷. In addition, AdultShop.com owns more than 70 other domain names. The Adultshop site is deliberately based on the successful Amazon.com Internet site (see Plate 1), with one German publication describing it as the 'Amazon of erotica'. The company estimates states that the Australian website had nearly 300,000 hits a month in 2000, with a 33 per cent conversion rate of visitors to paying customers.

Take in Plate 1

The recent decline of *Calvista's* successful phone sex business has meant that the company now has to reposition its entertainment activities, with the development of online entertainment including live-cams, and videos (both streamed and pay per view) being planned. The company have recently launched an entertainment site⁸ as a first step towards capitalizing on the growing number of high-speed Internet subscribers in the United States. This site launch will be followed by the inclusion of entertainment on all Adultshop product sites. As part of the move into entertainment, the company purchased *Redstone Films*. Due to strong international competition, the company is now seeking to develop opportunities through the use of networks, partnerships with international production companies, or co-branded products. While the opportunities in these markets are obvious, the question top be raised is how Adultshop will develop these markets without moving into the 'sex industry' that they initially wanted to position away from.

Constant investment in new technology, and improving the website is critical if the company is to maintain a first mover advantage (Boyer, 2001). Malcolm Day stated:

One thing someone told me – and we put this into practice on the technology side – is always employ people who are smarter than you are. Coming from a project management background myself, I knew the importance of having very competent people to develop Adultshop's Web site and make sure that its information technology capacity was top class.

The Company directors hired people they considered to be a leading e-tail online platform developers. In 2001 the website was substantially improved. Adultshop's Head of Technical, Iain Bradley stated: "We are expecting page download times to be somewhere in the region of ten times faster than the old site design." In conjunction with the new architecture the website has also received a makeover to bring it into line with the company's US website. Adultshop's Production Manager, Geoff Baldwin stated:

We are always aiming to keep the site looking fresh but we never sacrifice function over form. It should always be a case of making the pages look better but also making them load faster. There are a number of impediments to e-commerce and website performance is one issue that we aim to take out of the equation.

As well as the web presence, the company developed a strong brand campaign in traditional media outlets to make their target market aware of the brand and its values. Awareness is critical in the early stages of brand development, and for initial brand success (Ehrenberg and Goodhart, 2000). The aim of the advertising campaign has been to reduce the historical stigma attached to adult products, by the use of humorous advertisements in mainstream publications (see Plate 2).

The company has also brought its significant retail experience to bear on its online strategy, by becoming the first company online to offer a stock take, or ‘e-take’ sale, offering customers up to 50 per cent off erotic toys, adult videos, condoms and other such ‘naughty’ items that historically are not associated with the red flashing lights of a ‘stock take’ sale. The campaign was supported by a national advertising campaign using the cheeky and fun style that is associated with the brand (see Plate 2). These campaigns are also carried out in overseas markets. In November and December 2000, a targeted advertising campaign was run in Germany through print advertising in mass publications such as *TV Spielfilm*, *Tomorrow*, *Cosmopolitan* and *Max*, as well as online advertising on portals including *Infoseek* and *Yahoo*, and on websites such as *BildOnline*, *Tomorrow*, *Wahre Liebe* and *Amica*.

The company has also extended its concept of combining online and traditional retailing to its development of a branded mail-order catalogue in December 2000. The 32-page catalogue includes many of the most popular products on the website and is targeted at women, couples and individuals new to the erotic shopping experience. In offering its customers another way of purchasing adult products, the company was responding to the strong demand for their products from consumers who either did not have Internet access, or were not confident with shopping on the Internet at present. The website www.adultshop.com is heavily cross-marketed throughout the catalogue. In promoting the larger product range available online, it is hoped that print catalogue customers will have a strong incentive to become Internet customers. Orders will be shipped through the Company’s existing warehouse in Canberra, enabling the company to realise economies of scale in its supply and fulfilment functions. It is expected that at least three catalogues will be published each year.

However, the company still needed something to attract new consumers who were uncomfortable with shopping on the Internet. They also needed another mechanism to increase brand awareness (“Adultshop branded retail stores will both benefit from and strengthen the company’s brand presence”). In June 2001 Adultshop opened its first AdultShop.com retail store in the heart of Sydney's shopping centre, Oxford Street, Darlinghurst. The AdultShop.com store was the first adult store on Oxford Street to command a ground floor location. The company stated:

On 120 square metres, the modern, friendly and well-lit store offers lingerie, erotic toys, lotions and potions, books, games and novelties, videos, DVDs and fetish gear. The store design reflects the familiar AdultShop.com branding and focuses on attracting not only men, but also women and couples as customers.

Customers are greeted by an inviting display of lingerie items at the front of the store, which sets the tone for an enticing and sensual shopping experience and dispels any reservations customers, particularly women, may have about entering the Adultshop store. Richard McGinn, General Manager of Adultshop's Retail Division stated:

The store is an extension of the online AdultShop.com brand, offering women, couples and men a fun and comfortable environment in which to buy adult playthings. Just as Adultshop's websites have revolutionised the world of adult shopping, so has our first retail store.

One question that needs to be raised is whether this strategy will bring in new consumers (after all it does goes against the original reasoning behind going online), or will merely attract current customers (cannibalisation)?

Alliances and relationships

The use of relationships in business has been well documented in the past 20 years, although as Jallat and Capek (2001) state, the imminent demise of intermediaries due to the Internet is premature, and some suggest that relationships will (in some instances) become more important on the Internet than they have been in the past (Kothandaraman and Wilson, 2001; Borders, Johnston and Rigdon, 2001; Zineldin, 2000; Griffith and Palmer, 1999). For example, Kothandaraman and Wilson (2001) argued that electronic commerce would not replace traditional business-to-business relationships, but instead enhance them and extend the presence of the business. For Borders, Johnston and Rigdon (2001), the Internet had the potential to change the traditional dyadic view of industrial marketing, assisting the development of complex market networks. The establishment of relationships with both consumers and channel members would seem to be critical to the successful development of global online brands. For example, De Chernatony (2001) argues online brand managers would need to relax their approach to branding, and create a two-way dialogue between the customer and the firm.

Figures 1 and 2 indicate the evolving nature of Adultshop's relationships strategy. Initially (see Figure 1), the company developed relationships to ensure efficient local delivery. However, while the Directors of Adultshop have substantial business experience, and experience in adult product retail, they had little experience in the online arena. To gain this knowledge, they formed alliances with *Jupiter Communications* to provide online strategic planning services, web development company *New Toys Pty Ltd* for content assistance, and international advertising agency *Euro RSCG* (the second largest interactive agency in the world), to convince potential customers that adult products were 'mainstream'. This appears

to have worked: “One of the interesting outcomes of these efforts is that about 40 to 45 per cent of our online customers are women, which surprised some of us.” (Malcolm Day).

The company has also formed alliances with web search engines (*Yahoo! Australia & NZ*) to help gain exposure of their brand to new customers. These alliances with established players may help to increase the perceived ‘legitimacy’ of Adultshop, and therefore increase the likelihood of survival (Aldrich, 1999). The agreement with *Yahoo! Australia & NZ* ensured that Adultshop would be the exclusive merchant of adult products on *Yahoo! Australia & NZ Shopping*. Malcolm Day stated:

This agreement with Yahoo! allows us to extend the Web presence of www.adultshop.com and dramatically increase our access to consumers who demand quality products from superior merchants. With the recent successful launch of our German website...and the imminent launch of our U.S. website, we see Yahoo! as a powerful distribution platform that will help us gain access to millions of active online shoppers around the world.

Generating repeat business is the key to success for any e-tailer (Keh and Sheih, 2001). Having made good progress attracting customers to its sites, the next challenge for Adultshop was to live up to expectations and keep consumers coming back, stating in 2000:

Retaining customers has also been a must and a key part of our marketing strategy. Those of us previously involved in the adult products and services industry know this from experience and it is even more important in the online world.

While these programs were still under development at the time of writing much of the strategy imitates the *Amazon.com* strategy of creating personalised accounts, discussion boards, special offers, and reward schemes. The ability to do this results from the investments

made by Adultshop in website capability during their development. This slight refocusing, suggests that the company will now need to balance their acquisition and retention strategies, which will involve taking resources away from the necessary brand building activities of the firm. Also, *Amazon.com* have yet to turn this strategy into profitable cash flow, and it remains to be seen how firms can build a two-way relationship with consumers in an online environment (will the strategy have the effect of highlighting new products, which consumers then purchase elsewhere based on lower prices?).

Age of Order Entry and Learning Effects

Keh and Sheih (2001) stated that market penetration should be the first aim of new online entrants. In this case first movers have an advantage as they can realise economies of scale and develop technical know-how before competitors. However, this advantage does not last forever. In adult entertainment, competitive threats abound. For example, *Playboy* acquired *Rouze.com* and *New Frontier Media* purchased *igallery.net* and *igallery.com*. Newer firms such as pure online adult entertainment business *Private Media* also have serious growth plans, and an established track record of profitability. While Jallat and Capek (2001) have noted the potential for multiple offerings on the Internet, the danger for Adultshop is that specialised players can mount niche attacks on parts of the Adultshop business (such as *Private Media* in entertainment, or small retail stores in certain product lines or locations). Strategists have modelled the effects of age of order entry on later success, and have significant found effects, indicating that while generalists (e.g. Adultshop) were more successful in the early stages of industry development, later stages typically favoured niche specialists (Aldrich, 1999).

There is also a learning effect to take into account. Entrepreneurship theorists (Kirzner, 1997) have theorised how entrepreneurs learn from the actions of their competitors, or incumbents. New to market firms can quickly copy Adultshop's formula, which appears to be the 'dominant design' (Utterback, 1994), without having to go through the 'learning pains' of the incumbent. It has been suggested that Internet-only start-ups need to pay particular attention to constantly updating their technological base (Boyer, 2001). On the downside, the need to remain technologically up-to-date (not to mention ahead of the competition) can put a lot of strain on cash flow. New to industry firms are also unencumbered by current technology or sunk investments, nor may they have to worry about issues of 'legitimacy' if Adultshop is successful in overcoming this social barrier and changing the perception among mass market consumers of adult products. In a sense, Adultshop may educate the consumer about the legitimacy of these products, and then find these now educated consumers seeking to do business elsewhere (possibly through cut price discounters). Pitt, Berthon and Berthon (1999) have stated that the biggest threat posed by the Internet to traditional retailers was its ability to commoditise products and services as marketers struggle to differentiate their core activities. However, there is no reason to believe that this will not apply to online incumbents. These effects are likely to be heightened in the online environment due to the speed with which potential and current competitors can gain access to information, and replicate existing technologies.

CONCLUSION

To date, much of the debate in marketing about the use of the Internet evolves around the implications of the Internet for marketing practice, with little consideration given to the strategic and macromarketing variables that may impact on a firm's ability to successfully

integrate Internet technology into their marketing mix (Peterson, Balasubramanian and Bronnenberg, 1997). In trying to understand the strategic problems faced by Adultshop, and other Internet start-ups it became apparent that concepts from the wider strategic literature (such as population ecology, organizational life cycle and entrepreneurship) were useful in examining and accounting for marketing phenomena in this new medium. The use of a detailed case study, and a description of the business environment highlights a number of key variables, such as prior industry associations, legitimacy, liability of newness, and age of order entry that have typically been ignored in the marketing strategy literature. Future research should take these variables into account when examining the behavior of online firms, with longitudinal studies of the drivers of firm entry and exit being worthy of examination.

Much of the problems associated with Internet brand establishment relate to issues affecting new start-ups, and in particular industry innovators. While the use of a case from a 'fringe' industry such as adult entertainment could be expected to throw up a number of unique variables, and give undue focus to issues such as 'legitimacy,' the raising of this issue has broad implications for online businesses in general. The recent dot com crash, and post crash discussion about business models (Porter, 2001), indicates that the online medium must adopt legitimised business forms from the non-online world (or partner with established players), and adapt them to a new medium, while at the same time using the unique aspects of the web to 'revolutionalise' marketing. This requirement, plus the presence of established, resource rich non-online competitors (*Borders* vs. *Amazon.com* for example), means that for the foreseeable future, pure online companies will face a significant liability of newness problem, which will only exacerbate the legitimacy issues (as a number will continue to struggle, and go into bankruptcy). This means that 'hybrid' forms of online plus bricks and mortar retail

may offer a way ahead for start-up companies such as Adultshop with aspirations to develop global brands, and ultimately focus most of their retail activity online. For example:

It is difficult to conceive of pure-plays such as Peapod continuing to thrive by themselves as losses continue to build. It could also mean that bricks-and-clicks operations may be able to hold out more successfully than the pure-plays. (Keh and Sheih, 2001, pp. 82)

Whether this can be done effectively through alliances with established players, or as a stand alone business (with all the cash flow implications highlighted in the Adultshop case) remains to be seen, and future research is needed on both effective business strategies for online firms, and the evolution of said strategy. Finally, a detailed description of online firm ‘types,’ and their attendant market environments (or configurations along the lines of Mintzberg’s (1983) famous ‘Structures in Fives’) would be a useful area of future research.

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Table I: Evolution and Development of Adultshop

Date	Development
June 1999	Western Minerals NL (a public company listed on the Australian Stock Exchange) acquired the Internet rights to the Barbarellas name and trademark from the Barbarellas Group.
July 1999	Western Minerals NL was listed on the German stock exchanges.
August 1999	Western Minerals NL officially changed its company name to AdultShop.com Limited. The Company begins divesting itself of its mineral interests to focus on the sale of erotic products worldwide.
Jan 2000	Acquisition of the Barbarellas Group including the company Adult Communication Services. Official launch of the Australian website.
March 2000	Acquisition of 50% equity share in leading Australian wholesale companies Calvista Australia and Stell Bay.
April 2000	Purchase of a 50% share in the internet rights of Club X, the main competitor in Australia.
May 2000	Purchase of the domain names sexshop.com and pornshop.com
August 2000	Acquisition of leading Australian adult mail-order and distribution company AXIS, incorporating film producer Redstone Films
September 2000	Acquisition of remaining 50% of Calvista Australia and Stell Bay. Launch of German language website.
November 2000	AdultShop.com joins Yahoo! Australia and NZ Shopping
November 2000	First branded AdultShop.com bricks and mortar retail store opened in Sydney, Australia.
December 2000	Publication of first AdultShop.com couples mail-order catalogue. Launch of US website.
February 2001	Purchase of three retail stores in Australia's Northern Territory.
March 2001	Launch of US marketing campaign.
May 2001	AdultShop.com signs purchase contract for online entertainment company Today's Success Pty Ltd
June 2001	Website named Australia's number one e-commerce website by ZDNet

[1] www.adultshop.com.au

[2] Generally the German language documents were translations of English language articles or press releases.

[3] 1A\$= US\$ 0.51 approximately.

[4] Dodes (2001) notes how US police report that it is virtually impossible to keep track of the online adult industry.

[5] www.ausadultvideo.com.au

[6] In the US Adultshop has an arrangement with adult wholesaler IFC and guarantees order delivery within 72 hours, with no freight or shipping charges for orders worth more than US\$20.

[7] www.adultshop.com (US website), www.adultshop.com.au (Australian website), www.adultshop.de, www.barbarellas.com.au, www.private.com.au, www.clubx.com.au (50% ownership in joint venture), www.axisshop.com.au, www.sexshop.com, www.pornshop.com.

[8] www.SEXnow.com